



STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931
1-877-533-5020 (toll free)
Fax (608) 267-4549
<http://etf.wi.gov>

CORRESPONDENCE MEMORANDUM

DATE: November 1, 2010
TO: Wisconsin Deferred Compensation Board
FROM: Matt Stohr, Director of Legislation and Communications
SUBJECT: Legislative Report

This memo is for information only. No action is required.

As you are aware, the 2009-2010 Wisconsin Legislative Session began in January 2009 and the general business portion of the session concluded in April 2010. The 2010-2011 Wisconsin Legislative Session will commence in January 2011. To that end, there are not any current proposals to discuss at the upcoming Deferred Compensation Board meeting. However, a federal bill that will impact the Wisconsin Deferred Compensation (WDC) Program was recently signed into law and there was another federal bill that would have impacted the WDC if it would have passed.

Small Business Jobs Act of 2010

H.R. 5297, otherwise known as the Small Business Jobs Act of 2010, passed Congress and was signed into law by President Obama on September 27, 2010. Effective January 2011, the Act:

- Adds deferred compensation plans under § 457(b) to the definition of "applicable retirement plans" that can offer a qualified Roth contribution program.
- Allows participants to convert pre-tax amounts that are otherwise eligible for distribution from a 457(b) plan and other plans to Roth accounts within the same plan.

Please find attached the September 2010 issue of *Focus on 457* (a Great-West Retirement Services publication), which describes the impact of the Act on s. 457(b) and other plans in more detail.

The WDC Plan and Trust Document must be amended by the Board in order to allow participants to designate some or all of their deferrals as designated Roth contributions.

Reviewed and approved by Rhonda Dunn, Executive Assistant.

Rhonda Dunn 11-1-10
Signature Date

| Board | Mtg Date | Item # |
|-------|----------|--------|
| DC | 11.16.10 | 5 |

Required Minimum Distribution Moratorium

As you are aware, H.R. 7327, the Worker, Retiree, and Employer Recovery Act of 2008 (Recovery Act) was signed into law in December 2008. Generally, participants in qualified plans are required to take required minimum distributions (RMD) by April 1 of the year following: (1) the year they retire or (2) the year they attain age 70½, whichever is later. The Recovery Act provided a temporary, one-year moratorium on required minimum distributions from individual retirement plans (e.g., IRAs) and defined contribution plans qualified under Code § 401(a), 403(a), 403(b), and governmental plans under § 457(b). The one-year moratorium was effective for minimum distributions beginning after December 31, 2008. Great-West Retirement Systems (GWRS) mailed a notice to all affected WDC participants in 2009, explaining the moratorium and asking participants to contact GWRS if they would like their WDC RMDs suspended. Participants continued to receive their RMDs if they did not contact GWRS.

On April 22, 2009, H.R. 2021 was introduced. H.R. 2021, otherwise known as the Savings Recovery Act of 2009, would have extended the RMD moratorium through 2012, if enacted. HR 2021 was referred to the House Ways and Means Committee and other committees in the House of Representatives. However, it was not scheduled for a public hearing during the 2009-2010 Congressional Session and is unlikely to pass, as Congress has adjourned for the session.

I will be available at the meeting to answer any questions you have about these issues or any other legislative matters.

Attachment

Focus on 457SM

The Leading Technical Newsletter for Governmental Defined Contribution Plans since 1987

Published by The Government Markets Division of Great-West Retirement Services – Specialists in Government Defined Contribution Plans

VOLUME 23
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Edited by

Gregory E. Seller, Senior Vice President
Government Markets (800) 933-9808

Marilyn R. Collister, Senior Director
Legislative and Regulatory Affairs (303) 737-7712

Roth 457 Accounts Available January 1, 2011 Roth Conversions Allowed Within the Plan

The Small Business Jobs Act of 2010 (Act), which passed the Senate on September 16th and the House on September 23rd, and was signed into law by President Obama on September 27th, contains two provisions affecting Roth accounts within retirement plans. First, the Act adds governmental section 457(b) eligible deferred compensation plans to the definition of "applicable retirement plans" that can offer a qualified Roth contribution program beginning in 2011. Prior to passage, Roth elective deferral accounts were only available in 401(k) and 403(b) plans. Second, the Act allows pre-tax amounts that are otherwise eligible for distribution from a 401(k), 403(b) or governmental 457(b) plan to be converted to Roth accounts within the plan. Prior to passage of this Act, the conversion to a Roth account was only available by moving money eligible for distribution from a plan to a Roth IRA.

Roth Account Rules. Roth 457(b) accounts are not a new type of government 457(b) plan but rather a new type of elective deferral contribution called designated Roth contributions. Plan documents must be amended to allow employees to designate some or all of their elective deferrals as designated Roth contributions (which are included in gross income), rather than traditional, pre-tax elective contributions. With a designated Roth contribution, the employee irrevocably designates the deferral as an after-tax contribution that the employer must deposit into a designated Roth account. The employer includes the amount of the designated Roth contribution deferral in the employee's gross income at the time the employee would have otherwise received the amount in cash. It is subject to all applicable wage-withholding requirements.

Employees can contribute to both a designated Roth account and a traditional, pre-tax account in the same year in any proportion they choose. The combined amount contributed to all designated Roth accounts and traditional, pre-tax accounts in any one year for any individual is limited under Code §457(e)(15). The limit is \$16,500 for 2010 plus an additional \$5,500 in catch-up contributions in 2010 if the employee is age 50 or older at the end of the year. The special 457 catch-up limit in 2010 is \$33,000. These limits may be increased in later years to reflect cost-of-living adjustments.

These materials do not constitute tax or legal advice. Each situation is dependent upon its own complete set of facts. The reader should consult with an attorney or tax advisor and not rely upon these materials or attempt to apply them to specific situations.

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There are no limits on an employee's income in determining if he or she can make designated Roth 457(b) contributions. Of course, the employee has to have salary from which to make any deferrals. Also, the employee cannot change his or her mind and have designated Roth contributions treated as pre-tax elective contributions.

A designated Roth account is a separate account in a 457(b) plan into which an employee's designated Roth contributions, and their gains and losses, are allocated. The employer must separately account for all contributions, gains and losses to this designated Roth account until this account balance is completely distributed. This "separate account" requirement can be satisfied by any means so long as the designated Roth contributions, and gains and losses thereon, can be accurately tracked.

A qualified distribution from a designated Roth account is not included in the employee's gross income. A qualified distribution is generally a distribution that is made after a 5-taxable-year period of participation and is either:

- made on or after the date the employee attains age 59½, (and in the case of 457(b) plans, the employee is severed from service);
- made after the employee's death, or
- attributable to the employee's being disabled.

If a distribution is made to an alternate payee or beneficiary, then the employee's age, death or disability is used to determine whether the distribution is qualified. The only exception is when the alternate payee or surviving spouse rolls over the distribution to his or her own employer's designated Roth account, in which case their own age, death or disability is used to determine whether the distribution is qualified.

The 5-taxable-year period of participation begins on the first day of the employee's taxable year for which the employee first made designated Roth contributions to the plan. It ends when five consecutive taxable years have passed. If the employee makes a direct rollover from a designated Roth account under another plan, the 5-taxable-year period for the employee in the recipient plan begins on the first day of the taxable year that the employee made designated Roth contributions to the other plan, if earlier. When a reemployed veteran makes designated Roth contributions, they are treated as made in the taxable year with respect to which the contributions relate, as so designated by the reemployed veteran.

Employees cannot treat the following types of distributions from a designated Roth account as qualified distributions (or eligible rollover distributions) and must include any earnings paid out in gross income:

- Corrective distributions of excess deferrals under §457(e)(15)) (\$16,500 in 2010, \$22,000 if age 50 or older); or
- Deemed distributions under §72(p) (where the participant defaults on repayment of a loan from the plan).

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If the employee takes a distribution from his or her designated Roth account before the end of the 5-taxable-year period, it is a nonqualified distribution. The employee must include the income portion of the nonqualified distribution in gross income. However, the basis (or contributions) portion of the nonqualified distribution is not included in gross income. The basis portion of the distribution is determined by multiplying the amount of the nonqualified distribution by the ratio of designated Roth contributions to the total designated Roth account balance. For example, if a nonqualified distribution of \$5,000 is made from an employee's designated Roth account when the account consists of \$9,400 of designated Roth contributions and \$600 of earnings, the distribution consists of \$4,700 of designated Roth contributions (that are not includible in the employee's gross income) and \$300 of earnings (includible in the employee's gross income).

Even though an employee makes designated Roth contributions from after-tax income, the employee cannot take tax-free withdrawals from his or her designated Roth account at any time. The same restrictions on withdrawals that apply to pre-tax elective contributions also apply to designated Roth 457(b) contributions. If a plan permits distributions from government 457(b) accounts because of unforeseeable emergency, an employee may choose to receive that distribution from his or her designated Roth account. The unforeseeable distribution will consist of a pro-rata share of earnings and basis and the earnings portion will be included in gross income unless the employee has had the designated Roth account for 5 years and is either disabled or over age 59 ½.

Roth Conversion Rules. The Act permits pre-tax amounts that are otherwise available to be distributed as an eligible rollover distribution from 401(k), 403(b) and governmental 457(b) plans to be converted to Roth amounts within the plan so long as the plan permits regular Roth contributions. The intent of the Act is to reduce pension leakage by allowing amounts to be converted within the plan.

To be eligible for rollover to a designated Roth account, a distribution must be (i) an eligible rollover distribution, (ii) otherwise allowed under the plan, and (iii) allowable in the amount and form elected. For example, an amount in a 401(k) plan account that is subject to distribution restrictions (e.g., because the participant has not reached age 59-1/2) cannot be rolled over to a designated Roth account under the new rollover rules.

The effective date for conversions from 401(k) and 403(b) plans is the date of enactment. Plan sponsors must amend their plan documents if they wish to allow conversions. If plan amendments are adopted, distributions from 401(k) and 403(b) plans may be converted in 2010. Amounts converted in 2010 have special tax treatment with one-half of the tax due in 2011 and the other half in 2012, unless the individual elects to pay all the tax in 2010. Since Roth 457(b) accounts are not permitted until 2011, the 2010 conversion taxation rules would not apply.

Although there are many similarities between the treatment of Roth IRAs and designated Roth accounts, certain important differences apply. Each participant will have to carefully analyze the basis-first recovery rule, the first-time home buyer expense rule and the exemption from the required minimum distribution rules that apply only to Roth IRAs. Each of the differences between Roth IRAs and Roth accounts within the plan are beyond the scope of this article.

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Plan Amendments. Great-West will be amending our governmental 457(b) model plan document and adoption agreement for those plan sponsors who utilize our document and wish to adopt Roth 457(b) accounts. We will also be amending our governmental 401(k) and 457(b) model plan documents and adoption agreements to allow the adoption of Roth conversions.

If you have questions, please contact your Great-West Retirement Services® representative at the address below.

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|--|--|--|---|---|---|
| J. Chris Luttges, VP Field Ops/Plan Management 800-537-2033 ext. 71856 | Julie Klassen, Regional Director, Govt. Market Development 800-933-9808 | Kent Morris, Vice President, Western Region, 800-382-8924 | Theresa Cruz Myers, Vice President, Central Region 800-947-4409 | Brent Neese, Vice President, Eastern Region 978-407-9000 | Robert Dwyer, Manager, Market & Strategic Development 800-537-2033 ext 72408 |
| Perry Christie, Vice President 800-537-2033 ext 73724 | John Steggell, Regional Director, Irvine, CA 800-933-9808 | Linda Ulrich, Regional Director, Pacific Northwest 800-462-9277 | Michelle Williams, Director, National Accounts 800-537-2033 ext 74648 | Darryl Collier, Asst. Vice President 800-537-2033 ext 73291 | Lisa Tilley, Director, National Accounts 800-537-2033 ext 75159 |
| Trampus Bright Regional Director, Denver, CO 303-737-7706 | Denise Fortune, Regional Director, Maryland/DC 301-627-7579 | Cathy Matusiewicz, Regional Director, Irvine, CA 800-933-9808 | Brion Beetz, Regional Director, San Ramon, CA 800-274-8491 | Jim Condon, Regional Director, NY/NJ Region 718-238-2731 | Keith Anderson, Regional Director, Pittsburgh 610-716-3129 |
| Nancy Ornduff Regional Director, South Carolina 803.754.7997 | Marianne Franco, Regional Director, Glendale, CA 800-382-8924 | Usha Archer, Regional Director, Los Angeles, CA 800-382-8924 | Vanessa Coakley, Regional Director, Michigan 269-823-4020 | Gary Robison, Regional Director, City of Los Angeles 800-382-8924 | Jaimie Biesel, Regional Director, Indiana 877-728-6738 |
| Nancy Roth, Regional Director, Florida 904.652.3595 | Sue Oelke, Regional Director, Wisconsin 608-241-6604 | Gary Wilkins, Regional Director, Houston 713-426-5588 | Kris Morton, Regional Director Ohio 614-493-6185 | Karl Kroner, Regional Director, New England 800-596-3384 | Jim Rohlinger, Regional Director, Pennsylvania 717-901-3590 |
| Javier Obando, Regional Director, San Francisco 877-457-9321 | Connie Rettig, Regional Director, St. Louis 314-241-1334 ext. 105 | Connie Stevens, CRCP, Regional Director, Louisiana 255-926-8082 ext. 35501 | Donald Erwin Regional Director, Alabama 334.240.0057 | Alice Tajeron Regional Director, Guam/Micronesia 671-475-8945 | |

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